

ABANDONING FOREIGN DEPOSITORS IN A BANK FAILURE? THE EFTA COURT JUDGMENT IN *EFTA SURVEILLANCE AUTHORITY V. ICELAND*

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Abstract

Deposit insurance is a key issue in bank regulation. A mismatch exists, especially in the European Economic Area, between the freedom of banks to operate across borders and the fact that deposit insurance operates on a national basis. *EFTA Surveillance Authority v. Iceland* examines the protection of overseas depositors in the event of a cross-border bank failure. In *EFTA Surveillance Authority*, the court examined a state's responsibility to ensure compensation to depositors and possible discrimination against foreign depositors. This Article reviews the paradoxical holding by the court in light of the facts and circumstances of the case. Further, the Article discusses the concerns raised in *EFTA Surveillance Authority* regarding the degree to which EFTA states can adopt national economic policy arguments to differentiate between domestic and foreign depositors.

I. Introduction

The organization and design of deposit insurance is one of the core issues in the regulation of banks. Bank failures during the global financial crisis, exposed failings in the existing design of deposit insurance. In the context of cross-border banks, responsibility for the coverage of a banking group is segregated between different countries and this creates additional complications. Especially within the European Economic Area ("EEA"),¹ there appears to be a mismatch between the freedom of banks to operate across borders and the fact that deposit insurance operates on a national basis.

This Article attempts an exploration of these issues. It begins by examining the design and operation of deposit insurance in the EEA. The Article continues by examining a recent case in front of the Court of the European Free Trade Association ("EFTA") concerning the protection of overseas depositors, which arose from one of the most prominent bank failures in the financial crisis.² This Article critically comments on the issues raised by the case and on the reasoning of the

1. The EEA includes, beyond the member states of the European Union, three members of the European Free Trade Association ("EFTA"): Iceland, Liechtenstein and Norway.

2. Case E-16/11, *EFTA Surveillance Auth. v. Iceland*, 2013.

EFTA Court. This Article also considers broader policy issues and potential long-term implications, which could arise from the approach followed by the EFTA Court.

In particular, this Article argues that the absence of a high degree of harmonization of deposit insurance, together with wider policy considerations, has led the EFTA Court to an approach which may seem paradox taking into account the actual facts of the case. The reasoning that supports this approach is not always entirely persuasive. This Article also argues that, while parts of the judgment may not survive the increasing harmonization of deposit guarantee schemes in the wake of the financial crisis, broader statements raised by the Court raise concerns regarding the extent to which EFTA states can invoke national economic policy arguments to differentiate between domestic and overseas depositors.

II. The Regulatory Framework: Deposit Insurance in the European Economic Area

One of the core elements of banking regulation in the EEA is the “passporting” regime: once banks are authorized in a member state, they can provide services and establish branches freely throughout the EEA, without the need to establish local subsidiaries or obtain local authorization.³ The “passporting” right reflects the fundamental freedoms of services and establishment within the EEA as part of the wider objective to create an integrated, single market.

The bank that establishes a branch or provides services in another state (“host” state) is principally supervised by the state that authorized the bank (“home” state).⁴ The home state is also responsible to ensure that depositors of branches within the EEA are covered by a deposit insurance scheme in the home state, according to the provisions of Directive 94/19 on Deposit Guarantee Schemes (DGS Directive),⁵ as subsequently modified. Under the EEA Agreement,⁶ EU legislation on financial services, including the DGS Directive, is applicable throughout the EEA.

Under the DGS Directive, EEA member states are obliged to provide deposit insurance for banks’ branches in other EEA states, without discriminating between depositors of branches in other member states and depositors in the home state.⁷ According to the DGS Directive, deposit guarantee schemes should cover deposits up to a certain amount, and repay depositors within a certain timeframe.⁸ The DGS Directive provides that, as long as member states ensure that banks

3. Directive 2006/48 Relating to the Taking Up and Pursuit of the Business of Credit Institutions, 2006 O.J. (L177) 1–350 (EC), Title III.

4. *Id.*

5. Directive 94/19 on Deposit-Guarantee Schemes, art. 3, art. 4, 1994 O.J. (L135) 5 (EC) [hereinafter “DGS Directive”].

6. Agreement on the European Economic Area, Jan. 3, 1994, O.J. (L 1) 3 [hereinafter “EEA Agreement”]; see also EEA Agreement, Ann’x IX (regarding Financial Services).

7. EEA Agreement art. 4; DGS Directive art. 4 and recital 3.

8. DGS Directive, *supra* note 5, arts. 7, 10. Modifications subsequent to the facts of the case discussed increased the insured amount (from 20,000 ECU to 50,000 EUR, and subsequently 100,000 EUR) and reduced the time available for the payout (from three months to twenty days). Further, the insured amount is now harmonized throughout the EEA, while previously the DGS Directive stipulated only a minimum amount.

participate in deposit guarantee schemes introduced and recognized according to the provisions of the directive, it is the deposit guarantee scheme that is liable against depositors, and therefore potentially subject to actions brought by depositors, rather than the member state itself and its supervisory authorities.⁹

The allocation of responsibility for deposit insurance to the home state reflects the close link between, first, authorization and supervision of the bank and its branches—a home state responsibility—and, second, deposit insurance.¹⁰ It also ensures that depositors in the home state and in the host state are protected by the same deposit insurance scheme¹¹ and, therefore, subject to equal treatment. However, the allocation of responsibility for deposit insurance to the home state also creates the risk that, in the case of a banking crisis, the home member state may confer a higher level of protection to domestic depositors at the expense of foreign depositors. This issue was of particular concern to the depositors of foreign branches of Icelandic banks, which collapsed in the global financial crisis.

In the following sections, this Article considers the EFTA Court’s judgment with regard to the protection of overseas depositors in the failure of the Icelandic bank Landsbanki. Iceland, as a member of the EEA, but not of the European Union, is subject to the jurisdiction of the EFTA Court for matters of EU law. While judgments of the EFTA Court are not technically binding upon the Court of Justice of the EU (“CJEU”), the EFTA Court has often examined issues which had not previously been brought before the CJEU,¹² and the CJEU has referred to EFTA Court judgments on several occasions.¹³ Therefore, the EFTA Court’s judgments carry considerable weight.

III. The Facts: Icelandic Banking Crisis, Landsbanki Collapse and Restructuring, and the Fate of Overseas Depositors

*EFTA Surveillance Authority v. Iceland*¹⁴ arose from the failure of Landsbanki Islands hf¹⁵ (“Landsbanki”) bank. Iceland authorized Landsbanki. The bank established branches in the United Kingdom and the Netherlands, offering online savings accounts, which attracted significant amounts of deposits.¹⁶ In October 2008, and in the midst of the global financial crisis, Landsbanki came under significant stress. Within a few days, the online branches in the United Kingdom and in the Netherlands ceased to operate and depositors lost access to their accounts. Landsbanki collapsed and the Icelandic government acted under emergency legislation to establish a new bank, New Landsbanki, where it transferred domestic deposits.¹⁷ The United Kingdom took action to

9. *Id.* art. 7(6), recital 24.

10. *Id.* recital 7.

11. *Id.* recital 3.

12. Note that prior to the Lisbon Treaty (2009) references are made to the European Court of Justice (ECJ), the current CJEU’s predecessor.

13. Carl Baudenbacher, *The EFTA Court Fifteen Years On*, in EUROPEAN ECONOMIC AREA 1992–2009 (2009), available at http://www.eftacourt.int/fileadmin/user_upload/Files/News/2009/15_Years_EFTA_Court.pdf (studying the relationship between the ECJ and the EFTA court).

14. Case E-16/11, *EFTA Surveillance Auth. v. Iceland*, 2013.

15. *Hlutafelag*—This is the corporate designation in Iceland.

16. Case E-16/11, *EFTA Surveillance Auth. v. Iceland* ¶ 27, 2013.

17. Iceland’s Emergency Act No 125, 2008; Case E-16/11, *EFTA Surveillance Auth. v. Iceland* ¶ 33, 36 & 38, 2013.

freeze Landsbanki's UK assets.¹⁸ The Dutch government also acted under emergency legislation to wind down the local branch, including its Dutch assets.¹⁹

While the Icelandic depositors of Landsbanki were transferred to the new bank, the depositors in the UK and Dutch branches were compensated by the UK and the Dutch deposit guarantee schemes respectively.²⁰ The UK and the Dutch deposit guarantee schemes, together with institutional investors and some other depositors, submitted claims for compensation against the Icelandic deposit guarantee scheme.²¹ After the deadline for repayment by the Icelandic deposit guarantee scheme expired, the EFTA Supervisory Authority ("ESA") brought an action to the EFTA Court seeking a declaration that by failing to repay depositors in the UK and the Netherlands, Iceland breached its obligation to ensure that depositors are protected by a deposit guarantee scheme compliant to the conditions prescribed by the DGS Directive, and also breached its obligation for nondiscrimination against overseas depositors under the DGS Directive and under article 4 of the EEA Agreement.²² The European Commission intervened in support of the ESA.²³

IV. The Questions in Front of the EFTA Court and the Court's Judgment

The EFTA Court was called to answer three questions with regard to Iceland's behavior to transfer domestic deposits to the new bank and Iceland's failure to ensure the timely payment of compensation to depositors in the UK and Dutch branches of the minimum amount of deposit insurance.

The first question was whether Iceland's behavior breached its obligations under Articles 3, 4, 7, and 10 of the DGS Directive. Article 3 of the Directive requires member states to ensure that deposit-guarantee schemes are introduced and officially recognized and that authorized banks participate in such schemes.²⁴ Article 4 of the Directive stipulates that deposit guarantee schemes in a member state should cover the depositors in branches in other member states, which are established by banks authorized in the relevant member state.²⁵ Article 7 of the DGS Directive (as it stood in 2008) provided for a minimum coverage level of EUR 20,000 for each depositor.²⁶ Finally, Article 10 provided a time limit of three months for the repayment of deposits by deposit guarantee schemes, which could only be extended only in wholly "exceptional circumstances" and "special cases".²⁷

The second question was whether Iceland's behavior discriminated against depositors in the UK and in the Netherlands in breach of Articles 4(1) and 7(1) DGS Directive read in the light of Article 4 of the EEA Agreement. Article 4 of the

18. Under the Anti-Terrorism, Crime and Security Act, 2001. HM TREASURY, *The Landsbanki Freezing Order*, NAT'L ARCHIVES, http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/fin_stability_landsbanki.htm.

19. Case E-16/11, EFTA Surveillance Auth. v. Iceland ¶ 39, 2013.

20. *Id.* at ¶ 42; On the UK response, see HM TREASURY, *Icelandic banks: Frequently Asked Questions*, NAT'L ARCHIVES, <http://www.hm-treasury.gov.uk/8659.htm>.

21. Case E-16/11, EFTA Surveillance Auth. v. Iceland ¶ 49, 2013.

22. *Id.* at ¶ 61

23. *Id.* at ¶¶ 64, 66.

24. DGS Directive, *supra* note 5, art. 3.

25. *Id.* art. 4.

26. *Id.* art. 7.

27. *Id.* art. 10.

EEA Agreement is a nondiscrimination clause providing that “any discrimination on grounds of nationality shall be prohibited.”²⁸ As mentioned above, Article 4(1) of the DGS Directive provided that deposit guarantee schemes should cover the overseas branches in other member states.²⁹ Article 7(1) of the DGS Directive provided a minimum coverage of EUR 20,000.³⁰ Read together with Article 4 of the EEA Agreement, Articles 4(1) and 7(1) of the DGS Directive suggest that the deposit guarantee scheme should ensure the same treatment between domestic and overseas depositors in terms of coverage, payout and amount insured.

The third question was whether Iceland’s behavior discriminated against depositors in the UK and in the Netherlands in breach of the nondiscrimination clause in Article 4 of the EEA Agreement alone.

The EFTA Court answered all three questions in the negative.

V. The First Question: Responsibility of the State to Ensure Compensation to Depositors

With regard to the first question, the EFTA Court examined the question whether the DGS Directive created an “obligation of result” for EEA states.³¹ This means that EEA states would be responsible to ensure that insured depositors actually receive the amount of compensation prescribed by the Directive. If this were the case, the state of Iceland would be responsible to ensure that depositors of the overseas branches of Landsbanki would be repaid on time. Consequently, Iceland’s failure to ensure the timely repayment of deposits could be held to breach of Articles 3, 4, 7, 10 of the DGS Directive. In other words, Iceland’s alleged breach could have been a failure to have deposit guarantee schemes to repay depositors in branches in host states within three months for a minimum of EUR 20,000.

In order to assess whether the state of Iceland was under the obligation to ensure repayment of depositors, the Court interpreted the provisions of the DGS Directive as they stood at the time when the relevant facts took place (2008).³² According to the Court, the DGS Directive obliged member states to establish deposit guarantee schemes, and obliged competent authorities to ensure that banks participate in the schemes and comply with their relevant obligations.³³ However, the DGS Directive left considerable discretion to the member states as to the organization of the schemes. For instance, the DGS Directive did not refer to the methods of financing or the size of deposit guarantee schemes, leaving these issues to be determined by national legislation.

In addition, according to the EFTA Court, the DGS Directive obliged member states to ensure that national rules were adopted and maintained in order to cover the insured deposits, and to ensure that depositors have an action against the deposit guarantee scheme.³⁴ However, the Court continued, the DGS Directive

28. EEA Agreement, *supra* note 6, art. 4.

29. DGS Directive, *supra* note 5, art. 4(1).

30. *Id.* art. 7(1).

31. Case E-16/11, EFTA Surveillance Auth. v. Iceland ¶ 76, 2013.

32. That is, before the changes introduced by Directive 2009/14 of the European Parliament and of the Council amending Directive 94/19/EC on Deposit-Guarantee Schemes as Regards the Coverage Level and the Payout Delay, 11 March 2009, O.J. (L 68) 3 (EC) [hereinafter “Amended DGS Directive”].

33. DGS Directive, *supra* note 5, art. 3(1), art. 3(2)-(5) (discussing art. 3(1) and art. 3(2)-(5), respectively).

34. Case E-16/11, EFTA Surveillance Auth. v. Iceland ¶¶ 141–44, 2013.

did not oblige member states to ensure the payment of deposit insurance in all circumstances.³⁵ At this point, the Court emphasized that the answer might have been different under the new wording of Article 7(1) of the DGS Directive, which was replaced by Directive 2009/14.³⁶ The previous text of the Directive read that “Deposit-guarantee schemes shall stipulate that the aggregate deposits of each depositor must be covered”³⁷ The new wording reads that “Member States shall ensure that the coverage for the aggregate deposits of each depositor shall be”³⁸ According to the EFTA Court, under the new wording “[i]t appears that member states are under an obligation to ensure a certain level of coverage.”³⁹ However, the Court left the question open, and limited its interpretation to the old text of the DGS Directive, which was the relevant text for the case in question.

Further, the EFTA Court acknowledged that the DGS Directive obliged member states to ensure that the deposit guarantee scheme would be able to repay depositors within the requisite period.⁴⁰ However, according to the EFTA Court, this obligation was limited to creating an effective procedural framework, and did not require the member state to ensure compensation if funds were unavailable in the deposit guarantee scheme.⁴¹

In addition to the interpretation of the above Articles, the EFTA Court examined more generally the spirit and the objectives of the DGS Directive. According to the Court, the DGS Directive is intended to deal primarily with the failure of single institutions and not with systemic crises of the magnitude of the Icelandic crisis.⁴² In addition, EFTA Court emphasized that the objective of the DGS Directive is to create deposit guarantee schemes funded by the banking industry.⁴³ Should the funding of the deposit guarantee scheme be insufficient, the DGS Directive provides that depositors can bring an action against the relevant scheme.⁴⁴ However, the Court continued, the DGS Directive does not envisage any obligation on the state or a possible action against the state in those circumstances.⁴⁵

Finally, the EFTA Court referred to a number of reasons why, as a matter of policy, deposit guarantee schemes should not be backed by public funds. In particular, if member states were responsible to contribute to deposit guarantee schemes, this could possibly lead to competitive distortions, threaten the stability of the sovereign itself, and increase moral hazard on behalf of banks or of depositors.⁴⁶ In addition, the EFTA Court added that the Icelandic crisis was an exceptional case of a systemic crisis of such magnitude, that it would be inappropriate to hold Iceland liable for the repayment of deposits in the UK and Dutch branches.⁴⁷

35. *Id.* ¶ 178.

36. *Id.* ¶ 139; *see also* Amended DGS Directive, *supra* note 32.

37. DGS Directive, *supra* note 5, art. 7.

38. Amended DGS Directive, *supra* note 32.

39. Case E-16/11, EFTA Surveillance Auth. v. Iceland ¶ 139, 2013.

40. DGS Directive, *supra* note 5, art. 10.

41. Case E-16/11, EFTA Surveillance Auth. v. Iceland ¶¶ 145–49, 2013.

42. *Id.* ¶¶ 150–53.

43. *Id.* ¶¶ 155–59.

44. DGS Directive, *supra* note 5, art. 7(6).

45. Case E-16/11, EFTA Surveillance Auth. v. Iceland ¶ 160, 2013.

46. *Id.* ¶¶ 162–71.

47. *Id.* ¶ 178.

The Court concluded that Iceland was not liable under the DGS Directive for failing to ensure that overseas depositors would be repaid on time.⁴⁸ Rather, Iceland's obligation under the DGS Directive was to establish an effective framework for deposit guarantee schemes through the adoption and maintenance of the relevant rules and to ensure that domestically authorized banks participated in deposit guarantee schemes.

VI. Second and Third Questions: Discrimination Against Foreign Depositors

As both the second and the third questions had to do with the issue of nondiscrimination against foreign depositors under Article 4 of the EEA Agreement, it is worth examining the two questions together. In order to answer the second and the third questions, the EFTA Court considered whether the fact that domestic depositors were transferred to a new bank and thus given full protection, while foreign depositors were not given the same protection, constituted discrimination, in breach of the DGS Directive and/or Article 4 of the EEA Agreement.

The EFTA Court emphasized that article 4 and recital 3 of the DGS Directive, interpreted according to article 4 of the EEA Agreement, require equal treatment and nondiscrimination between domestic and foreign depositors.⁴⁹ Consequently, under the DGS Directive, the deposit guarantee scheme should not discriminate between domestic and foreign depositors in terms of treatment and payout.⁵⁰

The EFTA Court found that in this particular case, there was no question of such discriminatory treatment between domestic and foreign depositors. According to the Court, the transfer of Landsbanki's domestic deposits to the new bank was part of bank restructuring under Icelandic emergency legislation, which Iceland had the discretion to use.⁵¹ The Court also stated that, since domestic deposits were transferred to the new bank, they never became "unavailable" and therefore they were not eligible for deposit insurance.⁵² The situation was different regarding deposits in foreign branches, for which the repayment of deposit insurance was actually triggered.⁵³ Consequently, according to the Court, there was no issue of discrimination between domestic and foreign depositors under the DGS Directive, because the domestic depositors did not even qualify for deposit protection and therefore were not under the scope of the DGS Directive in the first place.⁵⁴

Finally, the EFTA Court examined the question whether under article 4 of the EEA alone the transfer of domestic deposits to the new bank would lead to an obligation to ensure minimum compensation for the foreign deposits.⁵⁵ The Court

48. *Id.*

49. Case E-16/11, EFTA Surveillance Auth. v. Iceland ¶¶ 206–10, 2013.

50. *Id.*

51. *Id.* ¶¶ 211–12.

52. *Id.* ¶¶ 214–16.

53. *Id.* ¶ 212.

54. *Id.* ¶ 216.

55. Case E-16/11, EFTA Surveillance Auth. v. Iceland ¶¶ 218–27, 2013.

answered this question in the negative.⁵⁶ The Court held that the principle of nondiscrimination under Article 4 of the EEA Agreement could not find a specific liability on the state of Iceland to ensure the repayment of foreign depositors.⁵⁷ In fact, even if such a specific obligation was deemed to exist, it would not have established equal treatment between domestic and foreign depositors, given that the two groups of depositors were in different circumstances.⁵⁸ In any case, the Court reiterated that member states have considerable discretion to deal with issues of economic policy, including restructuring measures for the banking sector.⁵⁹

VII. Critical Assessment of the EFTA Court's Judgment

EFTA Surveillance Authority v. Iceland demonstrates that the mismatch between cross-border operation of banks within the EEA and national organization of deposit guarantee schemes can create serious problems for depositor protection in case of a failure of a cross-border bank. Bearing this in mind, this section critically comments on the judgment of the EFTA Court. In order to attempt a critical assessment of the EFTA Court's judgment, it is useful to distinguish the two principal issues addressed in the judgment.

The first issue was whether a member state is liable under the DGS Directive to ensure that in effect covered depositors are repaid, even if the funds of the deposit guarantee scheme are inadequate. As was already mentioned, the EFTA Court answered in the negative, basing its judgment on legal arguments, but also taking into account broader policy considerations. The policy considerations to which the Court referred are particularly strong. More precisely, holding states responsible for the repayment of depositors would entail using taxpayers' money to cover bank losses, and could have a significant impact on the public budget. Further, the prospect of public funds being used to cover lost deposits could create moral hazard on behalf of banks and depositors themselves. For these reasons, the Court was right to emphasize that as a matter of policy it is important to ensure that depositor protection is not a state liability, but rather is a liability for deposit guarantee schemes, which are privately funded by the banks themselves.

The EFTA Court also interpreted the provisions of the DGS Directive and ruled that member states are not liable to ensure that depositors are actually repaid according to the provisions of the Directive. In other words, the DGS Directive does not create an "obligation of result" for member states. The case is not as simple as it may seem, and the elaborate legal issues that arise in the interpretation of the DGS Directive deserve closer consideration.

To begin with, the EFTA Court was right to conclude that member states are not responsible for the obligations of deposit guarantee schemes. The DGS Directive, its subsequent modifications,⁶⁰ and current proposals for a new DGS Directive ("2010 DGS Directive proposal") all provide support for the Court's

56. *Id.* ¶ 228.

57. *Id.* ¶ 226.

58. *Id.*

59. *Id.* ¶ 227.

60. DGS Directive, *supra* note 5, recital 24.

conclusion.⁶¹ However, the question whether the state should be liable in case the deposit guarantee scheme does not have the requisite size, organization, or funding resources to ensure timely repayment, is a different issue. The answer lies on the margin of national discretion left for deposit guarantee schemes, or, in other words, the prescriptiveness of state obligations with regard to deposit guarantee schemes, their size, coverage, and other characteristics. Therefore, the conclusion of the EFTA Court was reasonable: Iceland should not be liable for the obligations of its deposit guarantee scheme, merely because the latter was inadequate to cover depositors, as long as the design of the scheme was within the parameters of the DGS Directive and within the margin of discretion granted to member states. However, as discussed later in this section, the EFTA Court's assessment may lose in strength in the light of later developments in the EU deposit insurance framework.

The second main issue decided by the EFTA Court had to do with discrimination against foreign depositors. This is an issue of manifest importance, especially in the context of cross-border banking groups. The EFTA Court gave a narrow interpretation to the nondiscrimination principle. According to the Court, as long as domestic depositors never qualified for deposit insurance, the transfer of domestic deposits to the new bank did not constitute discrimination against foreign depositors, "whether it leads in general to unequal treatment or not".⁶² The Court's assessment seems quite paradoxical, given the background facts to the case. In essence, the end result was that domestic deposits were fully protected, while deposits in foreign branches were not covered—not even to the minimum amount prescribed by the Directive. Therefore, it is questionable whether the Court's assessment is in accordance with the spirit and the objective of the DGS Directive. Further, in reaching its conclusion that there was no discrimination, the Court focused on the technical fact that domestic deposits did not qualify for deposit insurance because they were transferred to a new bank. In doing so, the Court appears to accept that member states can de facto side-step the nondiscrimination principle and engage in preferential treatment of domestic depositors, by making use of mechanisms under national law, which leave foreign depositors unprotected.

Finally, the Court concluded its assessment on nondiscrimination by going further than the issues directly relevant to this case and by making more general observations with regard to nondiscrimination. In particular, the Court stated that "the EEA States enjoy a wide margin of discretion in making fundamental choices of economic policy in the specific event of a systemic crisis provided that certain circumstances are duly proven."⁶³ According to the Court, this discretion could constitute a ground for justification of the conduct of member states.⁶⁴ This approach raises concerns. Can EEA member states invoke a systemic crisis in order to take measures which differentiate between domestic depositors and depositors in foreign branches, potentially preferring the former to the latter? If this were the case, mutual trust and certainty within the EEA would be eroded.

61. *Commission Proposal for a Directive on Deposit Guarantee Schemes [recast]*, recital 30, COM (2010) 369 [hereinafter Proposed DGS Directive].

62. Case E-16/11, *EFTA Surveillance Auth. v. Iceland* ¶ 216, 2013.

63. *Id.* ¶ 227.

64. *Id.*

Depositors may be reluctant to place deposits with branches of banks authorized in other EEA states, if they are not guaranteed the same protection as domestic depositors. Especially in case of crisis, depositors may run on branches of foreign banks, under the fear that they might be left without protection and excluded from measures taken by the home member state.

VIII. Potential Future Impact of the EFTA Court's Judgment

This section assesses potential future implications of *EFTA Surveillance Authority v. Iceland*, taking into account later reforms in European deposit insurance legislation. In order to assess the future impact of the Court's judgment, it is again worth distinguishing between the two main issues decided by the Court.

The first issue was whether member states are under an obligation to ensure that depositors are repaid according to the provisions of the DGS Directive. It was already mentioned that this issue is closely related to the extent of discretion that member states enjoy with regard to the design of the national deposit guarantee scheme. The less discretion member states have to organize the deposit guarantee scheme, the more likely states are to be liable for the repayment of depositors, should the scheme fail to comply with the requirements prescribed in EU law. The old text of the Directive considered in *EFTA Surveillance Authority v. Iceland* left wide discretion to member states. However, amendments to the DGS Directive in 2009 significantly curtailed this national discretion. In particular, Directive 2009/14 harmonized the amount insured, reduced significantly national discretion in many areas, and mandated deposit guarantee schemes to cooperate with each other.⁶⁵ This means that it is possible that in the future, member states could be held liable for the obligations of deposit guarantee schemes, should the latter fail to comply with the provisions of the DGS Directive. This possibility was acknowledged by the EFTA Court in its judgment.⁶⁶

Notably, even more radical changes to the deposit insurance framework are in the pipeline. The 2010 DGS Directive proposal further restricts the discretion that member states have with regard to the design of deposit guarantee schemes. In particular, the 2010 proposal specifies the funding mechanisms for deposit guarantee schemes and the target levels for the size of the schemes. According to the 2010 proposal, deposit guarantee schemes should be funded through proportional bank contributions according to risk-based elements.⁶⁷ The 2010 proposal contains provisions for enhanced cooperation between deposit guarantee schemes at cross-border level. More specifically, the proposal envisages a system by which the host scheme would repay local depositors on behalf of the home scheme, as well as mutual lending facilities between national schemes. According to the 2010 proposal, member states would be obliged to ensure that schemes do not deviate from the coverage level stipulated by the DGS Directive.⁶⁸ While it remains to be seen which of these initiatives will reach the final directive,⁶⁹ it can

65. Amended DGS Directive, *supra* note 32, art. 4(5), art. 7(1a).

66. Case E-16/11, *EFTA Surveillance Auth. v. Iceland* ¶¶ 138–39, 2013. However, as already mentioned, the Court left the issue open, as it was not relevant to the facts of this case.

67. Proposed DGS Directive, *supra* note 61, at 7.5.

68. *Id.*

69. At the time of writing (May 2013), the 2010 proposal has been under considerable delay and is still in consultation phase.

be said with reasonable certainty that the new framework for deposit guarantee schemes will further reduce national discretion. This will trigger calls to reconsider whether member states should be liable when they fail to comply with such prescriptive obligations as to the design and funding of the schemes.

More broadly, the EU system for deposit insurance could change radically in the future. If deposit guarantee schemes cease to be national at some point in the future, *EFTA Surveillance Authority v. Iceland* would then be of little relevance. The creation of a pan-European single scheme is not an entirely improbable development, although unlikely in the near future.⁷⁰ A more plausible scenario is that in the future a single deposit guarantee scheme could be created for the member states of the Euro Area, and possibly other EEA member states, which choose to opt into such an arrangement.⁷¹ Any of these scenarios would call for re-thinking state liability in cases of insufficient funding for a cross-border scheme; the answer would greatly depend on the organization chosen for such a scheme.

The second main issue considered by the EFTA Court was the issue of nondiscrimination between domestic and foreign depositors. Given that the relevant provisions with regard to nondiscrimination in the DGS Directive and the EEA Agreement have not changed and no changes are currently proposed, the EFTA Court's analysis on this issue is more likely to remain relevant in the future. According to the EFTA Court's judgment, it appears that in a banking crisis, member states could transfer deposits to a new bank, as Iceland did, resulting in differential, but nondiscriminatory, treatment of domestic and foreign depositors. Further, the Court emphasized that "EEA States enjoy a wide margin of discretion in making fundamental choices of economic policy in the specific event of a systemic crisis."⁷² Should this approach be followed in the future, there is a risk that member states could call upon economic policy or financial stability considerations and differentiate between domestic and foreign depositors.

Notably, some comfort could be drawn by the fact that current proposals for a Directive on Bank Recovery and Resolution reduce discretion of member states as to the mechanisms they can employ in a banking crisis.⁷³ Therefore, the EFTA Court's reasoning with regard to broad national discretion when dealing with a systemic crisis may not hold strong in the future, in the light of increasing EU harmonization in the field of bank recovery and resolution. Finally, if deposit insurance schemes are created at cross-border level at some point in the future, deposit insurance would no longer be a matter for member states. It can reasonably be expected that cross-border deposit guarantee schemes could ensure

70. The 2010 DGS Directive proposal by the Commission did not put forward the creation of a pan-European deposit guarantee scheme, but left the issue to be discussed at a later stage.

71. This is one of the main proposals in the context of the "banking union", a move to centralize powers on the banking sector within the Euro Area at European level. See Memorandum from the European Comm'n on the Banking Union (June 6, 2012), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/12/413&>. The first step towards the banking union is the creation of a single supervisory mechanism. See Eilis Ferran & Valia Babis, *The European Single Supervisory Mechanism* (Univ. of Cambridge Faculty of Law Research Paper No. 10, 2013), available at <http://ssrn.com/abstract=2224538>.

72. Case E-16/11, *EFTA Surveillance Auth. v. Iceland* ¶ 227, 2013.

73. See *Commission Proposal For a Directive of the European Parliament and of the Council Establishing a Framework For the Recovery and Resolution of Credit Institutions and Investment Firms*, COM (2012) 280/3. At the time of writing (May 2013), the Proposal is still at consultation stage, with the vote in the European Parliament scheduled for October 23, 2013.

a uniform treatment of depositors at cross-border level, and therefore significantly reduce the probability of differential treatment between domestic and foreign depositors.

IX. Concluding Remarks

To conclude, *EFTA Surveillance Authority v. Iceland* demonstrates serious gaps in the EU's legislative framework as well as lack of cross-border cooperation in deposit insurance and bank restructuring. As this Article has discussed, some of these gaps have already been addressed in legislative reforms after the relevant facts for this case took place. However, this Article also discussed that if the intention is to ensure uniform treatment of depositors within the EEA, much remains to be done. The most fundamental reforms in EU legislation with regard to deposit insurance, recovery, and resolution have been significantly delayed and are still pending. Unless the legal framework for deposit insurance is reformed to deal with banks at cross-border rather than national level, the implications of deposit insurance segregated along national lines could be severe for banking integration in the European Economic Area.